

From: Carl-Gustaf Buren  
Sent: Donnerstag, 4. Oktober 2007 18:19  
To: Thomas Oversberg  
Subject: SV: IFRIC D 21: Comment Letter Submission

Dear Thomas,

At the discussions for the preparation of the industry CL the participants have taken part of the Efrag draft as a check-up on the views pronounced in the CL. However, particular comments to the Efrag draft have not been formalized or discussed per se. A general view I would say from our discussions is that although different Efrag members obviously have come to different conclusions (which weakens the impact of the draft) the development of arguments favouring the critical stance has been very succesful and exhaustive enough.

Best regards,

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International Financial Reporting Interpretation Committee  
30 Cannon Street  
London EC4M 6XH  
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### **IFRIC D 21 Real Estate Sales**

We appreciate the opportunity to respond to the International Financial Reporting Interpretation Committee's Draft Interpretation D 21 *Real Estate Sales* (D 21 below).

For reasons given below, we do not support D 21. IFRIC introduces limitations to the application of IAS 11 that do not follow from interpretation of existing standards. We do not agree with D 21 on the specific problems related to the revenue recognition of residential real estate developments. Moreover D 21 goes beyond these limits, introducing unjustified new revenue recognition elements also to the sale of commercial property projects. By excluding the application of a percentage of completion (PoC) method, D 21 delays the revenue recognition in cases of property development of all kinds. We, as listed Swedish companies, have in our capacity of contractors and developers already in a letter to IFRIC clearly underlined that the PoC method is the guiding principle for our operating models. D 21 would require us to come up with additional financial disclosures, creating less transparency and more complex reporting.

We present detailed our comments below.

#### **1. Continuous transfer of control and risks**

A key issue for D 21 is the description of the basis for IAS 11. In describing the basis for applying the stage of completion method, D 21 last paragraph of BC 5(b) stresses - without further explanations - that it *'not just recognises the value of the entity's activity in the period. Rather it recognises the economic benefits that the entity has delivered (via continuous transfer of control and risks and rewards of ownership) to the buyer as construction progresses.'*

We strongly question this interpretation. We find no references between D21 conclusions and IAS 11. Criteria such as transfer of control and risks and rewards of ownership are related to IAS 18 Sale of goods but have no relevance for the continuous approach expressed by IAS 11 or by IAS 18 Services. IAS 11 assumes there is a contract and a commitment for the seller, after due negotiations, to provide what is described in the contract; the seller specification. IAS 11 thereby focuses on contract revenue related to seller activities normally covering two or more accounting periods, but does not take into consideration e.g. whether there is a continuous transfer of control of risks and rewards or not. D 21 promotes a seller-buyer perspective of IAS 18 to be applied also on IAS 11, without any support for this from the standard itself. The proposed interpretation of D 21 goes beyond the objectives and indicates a lack of deeper industry knowledge of IFRIC in proposing new requirements of the standard.

#### **2. The concepts 'buyer specific' and 'construction services'**

We do not agree that 'a contract specifically negotiated for' (IAS 11.3) necessary should be described as a contract/agreement 'to provide construction services to the buyer's specifications' (D 21.8). The concept 'buyer's specification' has limited value and the

practical implications of describing relevant indications based on practical situations give rise to problems that are obvious, see D 21.9 (a) and D 21.10 (a).

Moreover, D 21.8 introduces additional uncertainty for users of IAS 11 in indicating that a construction contract would be limited to 'construction services' without taking into consideration that IAS 11 basically is directed to a construction of an asset (or combination of assets). IAS 11 is indicating the full scale of contract obligations i.e. to keep together all efforts for the client in terms of input of material resources and components, and of own and or hired party's work effort.

### **3. Ongoing convergence efforts**

In the present situation and in view of the different ongoing activities (among which we particularly would like to emphasize the EFRAG PAAinE revenue recognition project) to reach a coherent concept of revenue recognition, preparers and users are not helped by drastic changes of well-known concepts, let alone by an interpretation based on doubtful validity regarding its principal arguments.

### **4. The scope of D 21**

Our view is that the IFRIC has not taken into regard that D 21 has much wider implications, affecting the revenue accounting of business cases very much different from those initially set out by the IFRIC project. The residential real estate developments in themselves contain such a wide range of contractual scenarios that it is doubtful whether the consensus given will achieve the proposed standardizing of accounting practice. Besides the fact that the PoC-method already has established itself as a natural principle for accounting of revenues in a number of countries, it also has been explicitly considered by US GAAP as the one applicable.

To our view, the decision of D 21 not to apply the view of the SFAS 66 also marks an important step away from the PoC-method. The SFAS 66 not only mentions sale of apartments but also sale of the rights to use apartments on a time-sharing basis. The latter is an example of the extremely increased accounting complexity that we as preparers already have been addressing to IFRIC's attention. The D 21 conclusion presented in BC5 is in our view demonstrating circular reasoning. D 21 wrongfully assumes that agreements of the sale of residential units do not meet the IAS 11 definition.

### **5. Interpretation by analogy**

The D 21 implications on IAS 11 will have effects beyond its proposed scope. To what extent would for instance the concept 'buyer's specifications' be applied to contracts outside 'real estate sales' within the construction industry, shipbuilding, air craft industry, or manufacturing industry in providing contracted construction of assets and thereby cast out the relevance of IAS 11?

### **6. IFRS 8**

The construction industry, having long-term projects and using IAS 11 under a broader interpretation than the one proposed in D 21, will most certainly continue to use PoC accounting for management purposes. The D 21 would create large differences between segment reporting and financial statements when IFRS 8 Operating Segments is implemented.

## 7. Implications

The implications of D 21 are indicated above. We would however like to add the following (already highlighted in our previous letter to IFRIC):


Having its starting point in the D 21 delaying effects of revenue recognition compared to a PoC- approach, it will have a deep impact on all property development projects of the industry. D21 would also seriously delay revenue recognition in all real estate sales cases compared to the practice today where the equitable interest in a property vests in the buyer before legal title passes. Under all circumstances, the preparers would have to take in to consideration the loss of more timely revenue recognition application in their communication to the financial markets. Supplementary information would be required on activities performed during the reporting period (including agreements for sale of real estate before legal title has passed). This would demand pro forma financial presentations, creating disadvantages for both preparers (increased complexity, work load and costs) and users (less transparency and comparability).

Moreover, the impact of D21 would be such that construction contracts in general would not qualify for revenue recognition under IAS 11. We notice that D 21 by introducing the concept "buyer's specifications" may have an outcome that would affect and have implications for any construction contract even outside real estate sales, depending on the degree of modularisation and use of prefabrication in our application of increasingly industrialized construction processes. The implications would relate to systems and procedures for an entirely new classification of contracts and in depth affect the reporting of contract revenues.

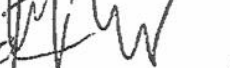
Adopting revenue recognition at one single point in time for projects with the complexity contained in construction contracts (with or without sales of real estate), expresses a misleading notion of objective precision in identifying the proper moment/reporting period to recognise revenue of a sale. In contrast, the PoC-approach expresses the degree of contract fulfilment at each point in time. Obviously, this is much more in line with the basic operating conditions of the construction industry.


Stockholm, 1 October 2007

Yours sincerely,

  
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